

Review of Fonterra's 2019/20 Milk Price Manual: Dairy Industry Restructuring Act 2001

Draft report

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Table of Contents

EXECUTIVE SUMMARY	III
WHAT THIS REPORT COVERS.....	III
ABOUT THIS REVIEW	III
CHAPTER 1 INTRODUCTION AND SCOPE OF REVIEW.....	6
SCOPE OF THIS REVIEW	7
CHAPTER 2 HOW YOU CAN PROVIDE YOUR VIEWS	11
INVITATION TO COMMENT	11
DEADLINE FOR SUBMISSIONS	11
REQUESTS FOR CONFIDENTIALITY	11
CHAPTER 3 DRAFT CONCLUSIONS.....	13
FONTERRA'S AMENDMENTS	13
MATTERS CARRIED FORWARD FROM PREVIOUS REVIEWS	14
INCLUSION OF QUALIFYING OUTLIER SALES	14
MATERIALITY	16
ATTACHMENT A DRAFT CONCLUSIONS ON MINOR AMENDMENTS.....	20
ATTACHMENT B OUTSTANDING AMENDMENTS PROPOSED EARLIER TO FONTERRA	21
ATTACHMENT C GLOSSARY	24

Executive Summary

What this report covers

- X1 This report sets out our draft conclusions on our review of Fonterra's 2019/20 Milk Price Manual (**the Manual**). The Manual contains the methodology that will be used to calculate Fonterra's base milk price for the 2019/20 season.

About this review

- X2 Our review of the Manual is required as part of the milk price monitoring regime (**monitoring regime**), which is contained in subpart 5A of the Dairy Industry Restructuring Act 2001 (**the Act**). An overview of our approach when reviewing the Manual can be found in our supporting paper "Our approach to reviewing Fonterra's Milk Price Manual and base milk price calculation" (15 August 2017).¹ This framework paper should be read together with, and as part of, this report. We did not make any changes to this framework paper for the purposes of this Manual review.
- X3 Our review considers the 'efficiency' and 'contestability' dimensions of the s 150A purpose as required by the Act. These focus on whether the methodology used in the Manual:
- X3.1 provides an incentive for Fonterra to operate efficiently (the 'efficiency dimension'); and
 - X3.2 adopts assumptions, inputs and processes that would be practically feasible for an efficient processor (the 'contestability dimension').²
- X4 To satisfy the provisions in s 150A, our interpretation is that our statutory reviews must assess the extent to which the Manual is consistent with both dimensions. We attach equal weight to both dimensions in our reviews.

¹ Commerce Commission "Our approach to reviewing Fonterra's Milk Price Manual and base milk price calculation" (15 August 2017). This paper provides an overview of the approach we have taken in reviewing the Manual. It outlines how we conduct our annual reviews of Fonterra's Milk Price Manual and each season's base milk price calculation. It includes our interpretation of key legislative provisions, our practical approach to the statutory reviews, an overview of how Fonterra sets its base milk price, assumptions of the notional processor, and internal and external controls surrounding the integrity of the milk price calculation.

² We consider the same 'efficiency' and 'contestability' dimensions when we carry out our milk price calculation review.

- X5 In reaching our draft conclusions we have focused on:
- X5.1 Fonterra's amendments to the Manual; and
 - X5.2 matters carried forward from previous reviews.
- X6 For those parts of the Manual that have remained unchanged we have relied on our previous conclusions. We are not aware of any other new information which would warrant reconsideration of our conclusions in previous Manual reviews, but welcome submissions in that regard.

Our draft conclusions

- X7 Our overall draft conclusion is that the Manual is largely consistent with the purpose of s 150A.
- X8 In regard to the specific matters we have reviewed, our draft conclusions are:
- X8.1 the amendments to the Manual from last season's Manual are of low materiality or improve transparency;
 - X8.2 the definition of Qualifying Outlier Sales is consistent with the contestability and efficiency dimensions set out in s 150A of the Act; and
 - X8.3 we continue to consider that disclosure of what constitutes a 'material change', when considering whether a change to the Manual should be made, will provide greater transparency.
- X9 As outlined in previous calculation reviews and Manual reviews we consider that the exclusion of farmer support costs from the milk price calculation is inconsistent with the contestability dimension of the purpose in s 150A, although these costs have not been significant to the base milk price.
- X10 There remain recommendations from previous reviews that we considered would better promote the purpose in s 150A and provide greater confidence to interested parties through additional transparency that have not been addressed in the current Manual. These recommendations relate to:
- X10.1 actual FX rates assumed; and
 - X10.2 capacity of standard plants.

Next steps

- X11 Based on Fonterra's 2019/20 Manual amendments and our draft conclusions on this review, we have not identified any new specific focus areas for our 2019/20 milk price calculation review.
- X12 In respect of the Manual's approach to asset stranding, we continue to consider that the best course of action is to monitor the asset stranding rules against real world behaviours for the time being, with a more substantive review to be included in the 2020/21 season after Fonterra's review of the specific risk premium.³

³ Commerce Commission "Review of Fonterra's 2018/19 Milk Price Manual: Dairy Industry Restructuring Act 2001 Final report" (14 December 2018).

Chapter 1 Introduction and scope of review

1. This report sets out our review of the extent to which the Manual is consistent with the purpose of the base milk price monitoring regime, which is set out in s 150A of the Act.

How this report is structured

2. This chapter introduces our review and covers the scope of our review.
3. Chapter 2 outlines how you can provide your views on our draft report.
4. Our draft conclusions of our review are set out in Chapter 3.
5. Minor technical and drafting amendments to the Manual, and our draft views on these, are set out in **Attachment A**.
6. Manual amendments that we proposed to Fonterra in prior reviews, and which we consider still outstanding, have been summarised in **Attachment B**.
7. A glossary of key terms is provided in **Attachment C**.
8. This paper should be read with the paper "Our approach to reviewing Fonterra's Milk Price Manual and base milk price calculation" (15 August 2017) which we have applied in this Manual review and which forms part of this report.⁴

We are fulfilling our statutory requirements

9. We are required to review the Manual for each dairy season and make a report on the extent to which the Manual is consistent with the purpose statement of subpart 5A of the Act, as set out in s 150A of the Act.⁵
10. The Act requires Fonterra to provide us with the following information for consideration in our review:⁶

10.1 the Manual for the current season;

⁴ Commerce Commission "Our approach to reviewing Fonterra's Milk Price Manual and base milk price calculation" (15 August 2017).

⁵ As required under s 150H and s 150I of the Act.

⁶ Section 150L of the Act.

- 10.2 any recommendations by the Milk Price Panel (**MPP**)⁷ in relation to the setting of the base milk price;⁸
 - 10.3 notification of any change in the economic and business environment that, in Fonterra's view, requires a change to the Manual;
 - 10.4 certification on the extent to which Fonterra considers that the Manual is consistent with the purpose of s 150A; and
 - 10.5 reasoning behind the views expressed in Fonterra's certification.
11. The above information, where relevant, has been provided by Fonterra in the 'Reasons' Paper in support of Fonterra's Manual for the 2019/20 season and has been considered as part of our review. Fonterra's Manual and the Reasons Paper can be found on our website.⁹

Scope of this review

12. We have focused our review on:
- 12.1 Fonterra's amendments to the Manual made since the 2018/19 review; and
 - 12.2 matters carried forward from previous reviews. These are:
 - 12.2.1 Qualifying Outlier Sales; and
 - 12.2.2 Materiality.
13. For those parts of the Manual that have remained unchanged from the 2018/19 Manual we have relied on our previous conclusions. We are not aware of any other

⁷ The MPP is a committee that Fonterra is required to establish and maintain under s 150D of the Act. The MPP is required to, for each season, supervise the calculation of the base milk price; advise Fonterra on the application of the Manual; and recommend the base milk price to Fonterra. See also Fonterra "Farmgate milk price manual" (1 August 2019), page 26.

⁸ Fonterra provides the Commission a 'marked up' version of the Manual that shows the changes that have been made to the previous season's version of the Manual. Fonterra has stated in its Reasons Paper (page 1) that the 'marked up' version of the Milk Price Manual attached to its Reasons Paper identifies all amendments to the Manual. For the 2019/20 Manual, all the recommendations by the MMP were implemented by the Board.

⁹ Fonterra "Fonterra's Reasons Paper in support of Milk Price Manual for the 2019/20 season" (2019) at <https://comcom.govt.nz/regulated-industries/dairy/milk-price-manual-and-calculation/milk-price-manual>

new information which would warrant reconsideration of our previous conclusions, but welcome submissions in that regard.

14. This review has been carried out following Fonterra’s four-yearly review of the Manual to determine whether the Manual is satisfying (or could better satisfy) the Milk Price Principles.¹⁰ We have reviewed all of the changes to the Manual for the 2019/20 season, irrespective of the reasons why they have been made.
15. For the sake of clarity, this principles four-yearly review is distinct from the periodic reviews of specific matters that are required by the Manual.¹¹ For example, an “independent reviewer” is required to recommend an updated specific risk premium for the Weighted Average Cost of Capital (**WACC**), with the next update occurring for the 2020/21 season.¹² As explained further at paragraph 19 below, we intend to undertake a more substantive review of the asset stranding rules in the 2020/21 season after Fonterra’s review of the specific risk premium in that season.
16. In this report we have grouped issues in the following order:
 - 16.1 The areas of the Manual that are most likely to have an impact on the extent to which the Manual is consistent with s 150A taking account of new information and changes to the Manual (Chapter 3).
 - 16.2 Minor amendments to the Manual of a technical or drafting nature (Attachment A).
 - 16.3 A summary of the Manual amendments we have proposed to Fonterra over the course of our milk price reviews which have not been adopted. Given the ongoing nature of our reviews we consider these issues to be of continuing relevance (Attachment B).

We will consider asset stranding in our 2020/21 Manual review

17. Asset stranding occurs when the reduction of milk supply results in the permanent removal of assets. Our focus has been how the Manual accounts for the capital costs

¹⁰ This review is required by rule 5.4(d) of the Manual. The Milk Price Principles are contained in Fonterra’s constitution, which requires the Manual to reflect the Milk Price Principles (see page 5 of the Manual).

¹¹ These specific four-yearly reviews are set out in the definition of “Review Year” on page 89 of the Manual.

¹² See Rule 42 of the Manual and the definition of “Review Year”.

of milk collection and processing in the event that the volumes of milk collected and processed by Fonterra were to remain static or permanently decline over time.

18. In our final report on the 2017/18 milk price calculation, we stated that we intended to monitor volume of milk collected by Fonterra for the purpose of determining whether a sufficiently large and consistent decline in milk volume might give rise to the permanent mothballing of plants and associated issues about the treatment of sunk costs in the calculation.¹³
19. In our final report on the 2018/19 Manual we concluded that the rules relating to asset stranding are consistent with the efficiency dimension and that the contestability dimension was satisfied due to the 'safe' harbour provisions in s 150B of the Act.¹⁴ In respect of whether asset stranding had occurred in light of lower than expected milk volumes for the previous two seasons, we concluded that the best course of action would be to monitor the asset stranding rules against real world behaviours for the time being with a more substantive review to be included in the 2020/21 season alongside Fonterra's review of the specific risk premium.¹⁵
20. As part of our review of the 2018/19 milk price calculation, we reviewed changes that Fonterra made to the calculation assumptions to deal with the higher than expected milk volumes for the 2018/19 season. We confirmed in our report on the 2018/19 calculation that Fonterra had made appropriate adjustments to the milk price calculation to reflect the plant and site costs required to process the additional milk volumes.¹⁶
21. We had previously stated in our approach paper setting out our proposed focus areas for our review of Fonterra's 2018/19 calculation that we would look to include the long-term issue of asset stranding in our review of the 2019/20 Manual, after Fonterra's four-yearly review of the Manual to determine whether it is satisfying (or could better satisfy) the Milk Price Principles. Our intention was to review any changes to the asset stranding rules that might have come out of this review. As

¹³ Commerce Commission "Review of Fonterra's 2017/18 Milk Price Calculation – Final report" (14 September 2018), pages 14 & 15. At page 14 we made the distinction between Mothballing, which occurs when the reduction of milk supply results in the temporary removal of assets to reduce variable costs.

¹⁴ Commerce Commission "Review of Fonterra's 2018/19 Milk Price Manual - Final report" (14 December 2019), paragraphs 56-70.

¹⁵ Commerce Commission "Review of Fonterra's 2016/17 Milk Price Manual – Final report" (14 December 2016), paragraph 47.

¹⁶ Commerce Commission "Review of Fonterra's 2018/19 base milk price calculation" (12 September 2019), paragraph 2.106.

there have been no changes to the rules that deal with asset stranding in the 2019/20 Manual, we continue to consider that the best course of action is to conduct a more substantive review in the 2020/21 season, alongside Fonterra's scheduled review of the specific risk premium.¹⁷

¹⁷ Commerce Commission "Proposed approach and focus areas for our review of Fonterra's 2018-19 base milk price calculation" (7 June 2019).

Chapter 2 How you can provide your views

Invitation to comment

22. As required under the Act, we are consulting with Fonterra on this draft report.¹⁸ We have also extended our consultation process to other interested parties.
23. This chapter outlines how you can provide your views on our draft report.
24. We welcome views on any aspects of this draft report that you think we should consider before finalising our conclusions. As signalled in this paper we are particularly interested in material relating to any new information that would warrant further consideration of previous conclusions.

Format of submissions

25. Submissions must be provided electronically in a format suitable for word processing.
26. We intend to publish all submissions on our website. If you would like the published electronic copy to be 'locked', we ask that you provide multiple versions of your submission. At least one version should be provided in a file format which is suitable for word processing.

Deadline for submissions

27. Submissions should be provided to us no later than **5pm, Friday 15 November 2019**.
28. You should address your response to:

Matthew Clark, Acting Manager – Regulatory Developments, Regulation Branch

regulation.branch@comcom.govt.nz
29. We will consider submissions and publish our final report by **Friday 13 December 2019**.

Requests for confidentiality

30. We encourage full disclosure of submissions so that all information can be tested in an open manner. However, we offer the following guidance where you wish to provide information in confidence:

¹⁸ Section 150U(1) and (2) of the Act.

- 30.1 If you include confidential material in a submission, both confidential and public versions of the submission should be provided; and
- 30.2 The responsibility for ensuring that confidential information is not included in a public version of a submission rests entirely with the party making the submission.

Chapter 3 Draft conclusions

31. This chapter summarises our draft conclusions on the extent to which the 2019/20 Manual is consistent with the s 150A purpose. Our overall draft conclusion is that the 2019/20 Manual is largely consistent with the s 150A purpose.
32. As outlined in previous calculation reviews and Manual reviews, we consider that the exclusion of farmer support costs is inconsistent with the contestability dimension of the purpose in s 150A, although these costs have not been significant to the base milk price.
33. There remain recommendations from previous reviews that we considered would better promote the purpose of the Act and provide greater confidence to interested parties through additional transparency that have not been addressed in the current Manual. These recommendations relate to:
- 33.1 actual FX rates assumed; and
 - 33.2 capacity of standard plants.
34. These matters are discussed in Table B1.

Fonterra's amendments

35. Table 3.1 summarises Fonterra's changes to the 2019/20 Manual, Fonterra's specific commentary in its 2019/20 Reasons paper, and our draft conclusions on the changes.

Table 3.1 Summary of our draft conclusions on the impact of Fonterra's amendments on consistency with the s 150A purpose¹⁹

Manual reference	Amendment	Fonterra comment	Our draft conclusion
p.73	The definition of Standard Plant has been amended to provide that these plants are suitable for the manufacture of a "Standard Product Offering".	In response to Miraka's proposal, endorsed by the Commission, ²⁰ that Fonterra define a "standard plant" as "the [notional processor] plant which is designed to produce the GDT product range". The amended definition effectively defines a standard plant as one which can be used to manufacture a "Standard Product Offering".	The amendment to this rule improves clarity and is consistent with the s 150A purpose.

¹⁹ See also Attachment A which outlines the amendments of a minor or drafting nature.

²⁰ Commerce Commission "Review of Fonterra's 2018/19 Milk Price Manual - Final report" (14 December 2019), paragraph 15.

Manual reference	Amendment	Fonterra comment	Our draft conclusion
p.64	The definition of “Standard Product Offering” has been amended to delete the reference to “Can be manufactured in Standard Plants” from the list of required Generic product specifications, if the product is not sold on GDT.	Consequential on the proposed amendment to the definition of Standard Plant, to avoid what would otherwise be a circular reference.	The amendment to this rule improves clarity and is consistent with the s 150A purpose.

Matters carried forward from previous reviews

Inclusion of Qualifying Outlier Sales

36. In our review of the 2018/19 Manual we undertook to seek clarification in our 2018/19 calculation review of what “Qualifying Outlier Sales” (**QOS**) comprise or are likely to comprise, and to identify whether they have had an impact on the selling prices of the notional producer (**NP**).²¹
37. The definition of QOS allows for the re-inclusion in the milk price calculation of a sale of an Reference Commodity Product (**RCP**) that had been excluded by the Milk Price Group (**MPG**)²² under the definition of “Qualifying Reference Sales” (**QRS**) on the basis that the price at which the contract for the sale was entered into did not reflect prevailing market prices.
38. As a practical matter, the exclusion of sales is given effect in the milk price calculation by the application of a non-automated review processes, such as contract pricing reviews by the MPG or internal/external audit. This non-automated process is adopted because the automated selection criteria applied to sales data do not incorporate any pricing threshold. If sales are excluded by this process the definition of QOS provides that the MPP may reverse an exclusion if, “on the balance of probabilities, the net impact of Fonterra undertaking the sale will be to result in a

²¹ This was in response to Miraka’s submission. See Commerce Commission “Review of Fonterra’s 2018/19 Milk Price Manual - Final report” (14 December 2019), paragraph 16. Miraka “Miraka submission to the Commerce Commission: Draft report (15 October 2018): Review of Fonterra’s 2018/19 milk price manual” (16 November 2018), paragraph 1.7.

²² The Milk Price Group carries out the day-to-day administration of the Manual. Fonterra “Farmgate milk price manual – Part A: overview” (1 August 2019), page 27.

higher Farmgate Milk Price than would otherwise have been the case". This will involve the exercise of commercial judgement.

39. Fonterra confirmed for the 2018/19 calculation review that the calculation solely reflected the application of automated criteria, thus there were no RCP sales excluded on the basis of any review of prevailing prices and hence no need for the MPP to decide whether to re-include sales under the definition of QOS.²³ Therefore, for the 2018/19 milk price calculation, there was no impact of QOS on the sales prices of the NP.
40. As part of this year's Manual review, we sought clarification regarding what QOS might comprise. We did this by requesting clarification on:
 - 40.1 how Fonterra would apply its discretion around including QOS; and
 - 40.2 what level of pricing would not reflect "prevailing prices" for the purpose of excluding a sale under the definition of QRS.
41. Fonterra has confirmed that it always includes a sale in the milk price calculation where it satisfies the inclusion criteria in the definition of QRS, as required by the definition of QRS, and that it has not had cause to rely on the definition of QOS to re-include a sale.
42. Fonterra has further explained that when the QOS definition was introduced, it was envisaged that certain sales that would otherwise satisfy the QRS definition criteria might be rejected where the MPG considered the price was too far 'below market' to be included in the milk price calculation. In those circumstances the QOS definition would allow the MPP to form a different view and re-include these sales, using information that may not have been considered relevant by the MPG, including relating to wider market considerations.²⁴
43. Fonterra has provided the following explanation for why sales at 'below market prices' might be included because they would have a net impact of increasing the milk price. Fonterra explained that the QOS definition was designed to deal with market dynamics and attitudes that existed in 2008/09, when demand and prices were spiralling downwards, which are unlikely to be present today. In these circumstances, it might be possible to accept sales that are below prevailing market

²³ Commerce Commission "Review of Fonterra's 2018/19 base milk price calculation" (12 September 2019), paragraph 2.95.

²⁴ Fonterra explained that, at the time this provision was introduced, GDT was a newly developed platform which only sold WMP on a monthly basis, which meant that Fonterra did not have GDT-based references for market prices for other RCPs.

prices that nonetheless result in a higher milk price than would otherwise be the case. This is because the market is not aware of the terms and conditions of the sale and therefore the sale will not send pricing signals that will encourage the downward spiral.

44. Fonterra has stated that the rules were drafted specifically with below market prices in mind, but has acknowledged that the exclusion of non-prevailing price sales under the definition of QRS is agnostic between high and low prices.
45. Fonterra notes that the QOS definition has not been exercised since 2009/10 and, given the Manual's definition of QRS and the interplay with the QOS definition, situations where the QOS definition would apply would be highly unusual and infrequent.
46. Fonterra has also confirmed that sales are deemed to be at prevailing prices as long as internal approval processes and delegated authorities have been complied with.

Our draft conclusion on the Qualifying Outlier Sale rule

47. We are comfortable in light of Fonterra's explanation of the purpose and context to be applied to the interpretation and application of this rule, that it does not provide Fonterra any effective discretion to increase the milk price in other than the rare situation where a sale at below prevailing prices would have the effect of increasing the milk price, thereby justifying its re-inclusion. In practice the QRS rule and automated selection criteria operate to include all arms-length RCP sales where the contract complies with the relevant Fonterra Risk Management Policy. Therefore, our draft conclusion is that the QOS definition, in conjunction with the QRS definition, is consistent with the contestability and efficiency dimensions set out in s 150A of the Act.

Materiality

48. In our review of the base milk price calculation for 2016/17, we expressed concern that the Manual does not define:²⁵
 - 48.1 what is considered a 'material change' when considering a change to the Manual; and
 - 48.2 the timeframe for making such a change.

²⁵ Commerce Commission "Review of Fonterra's 2016/17 Milk Price Manual – Final report" (14 December 2016), paragraph 59.

49. Fonterra has previously stated that it will disclose any change in approach that results in a materially different value of an input used to calculate the farmgate milk price.²⁶ Fonterra has also previously advised that not setting a materiality measure is intentional and that this enables additional discretion to disclose changes irrespective of whether there is a material impact on the calculation.²⁷ Fonterra maintains that a ‘bright line’ materiality threshold is likely to lead to less disclosure.²⁸
50. We do not believe that a materiality threshold applied in respect of making changes need then also be applied to the disclosure of changes, so as to reduce the level of disclosure. As with financial reporting, various matters might be disclosed at the discretion of the Board that do not constitute material matters.
51. In our review of the base milk price calculation for 2018/19 we signalled that we intend to address materiality considerations as they apply to Manual changes in this Manual review.²⁹

Materiality for considering changes to the Manual

52. As part of this year’s Manual review, we asked Fonterra to explain its materiality threshold/decision making criteria applied when considering changes to the Manual. Fonterra has explained that because of the nature of the changes it has made to the Manual, it has not needed to formally consider the nature of any materiality threshold.
53. Fonterra has advised that since 2014, changes to the Manual were intended to address matters raised by the Commission and have arisen in order to:
- 53.1 improve transparency by:
- 53.1.1 making a rule more explicit, for example, the 2016/17 amendment to the then Rule 14 relating to the calculation of repairs and maintenance costs;

²⁶ Fonterra “Fonterra’s reasons paper in support of the milk price manual for the 2016/17 season” (1 August 2016), page 6.

²⁷ Commerce Commission “Review of Fonterra’s 2016/17 Milk Price Manual – Final report” (14 December 2016), paragraph 60.

²⁸ Fonterra “Fonterra’s reasons paper in support of the milk price manual for the 2019/20 season” (1 August 2019), page 4.

²⁹ Commerce Commission “Review of Fonterra’s 2018/19 Milk Price Manual - Final report” (14 December 2019), paragraph 2.56.3.

- 53.1.2 codifying Fonterra’s position regarding disclosure, for example, the 2014/15 inclusion of undertaking to disclose in the Milk Price Statement material changes in the calculation methodology; or
- 53.1.3 making a rule more prescriptive, for example, the 2014/15 amendment to the definition of “Benchmark Selling Price”, to make it explicit that only sales contracted up to and including five months before shipment would be included in milk price revenue.
- 53.2 amend process requirements. For example, the 2015/16 amendment to Rule 6 brought sales costs into the scope of the four yearly overheads reset review;
- 53.3 address matters where the Manual was incomplete. For example:
 - 53.3.1 a rule was added to the Manual for 2015/16 relating to non-recurring costs, noting that this rule codified existing practice; and
 - 53.3.2 a specific risk premium was added to the WACC, in 2014/15 to address the Commission’s position that the WACC did not adequately compensate for all forms of risk.
- 53.4 better align a rule to provisions under the Act. For example, the 2015/16 amendment to Rule 3 provided that amendments to the basket of RCPs should occur only when this can be expected to result in a higher milk price, consistent with section 150C(2)(b)(i);
- 53.5 better align the Manual with the Milk Price Principles and Fonterra’s Constitution. The only amendment to the Manual under this key driver was the 2016/17 re-inclusion of off-GDT sales of WMP, SMP and AMF in the milk price; and
- 53.6 correct errors, such as incorrect cross references.
- 54. In respect of the re-inclusion of off-GDT sales of WMP, SMP and AMF in the Milk Price, Fonterra has informed us that the primary purpose of this change was to better align the calculation of the milk price to the Milk Price Principles.³⁰

³⁰ This was noted in Fonterra’s NZX release at the time. The media release stated the change was required to meet “Fonterra’s Constitutional requirement to pay the maximum sustainable Milk Price and regulatory requirements to pay an efficient, competitive Milk Price.” This media release can be found here: <https://www.nzx.com/announcements/286479>

Our draft conclusion on materiality

55. Fonterra's explanation suggests that there are many situations whereby changes can be made to the Manual that do not give rise to costs through the milk price. It is not clear, however, what materiality considerations would apply to a decision that may have a cost or revenue impact or to a decision that no change is needed.
56. We consider it would improve transparency if the Manual defined a threshold or set of criteria that would be used by Fonterra to categorise amendments to the Manual (for example, improvements in transparency, addressing matters where the Manual was incomplete and correction of errors), but Fonterra otherwise retained the discretion to make any changes to the Manual.
57. Therefore, our draft conclusion continues to be that disclosure of what constitutes a 'material change' in this context will provide greater transparency.³¹

³¹ Commerce Commission "Review of Fonterra's 2018/19 Milk Price Manual – Final Report" (14 December 2018), page 24. We note that Fonterra has provided comments on their view of materiality in terms of subpart 5A of the Act. These comments can be found here:
https://comcom.govt.nz/_data/assets/pdf_file/0024/173823/Fonterra-Submission-on-review-of-Fonterra-base-milk-price-calculation-draft-report-2-September-2019.pdf

Attachment A Draft conclusions on minor amendments

58. This attachment highlights minor technical and drafting changes made by Fonterra.

Table A1 Summary of minor technical and drafting changes

Manual reference	Amendment	Fonterra comment	Commission comment
Various pages	Cross references update	Amendments were made to correct cross references.	We consider that these are the correction of errors.
p.61	The definition of sales cost has changed from “for a <i>month</i> , the amount calculated under Rule 17” to “for a <i>Season</i> , the amount calculated under Rule 17”.	No comment in the Reasons paper.	We consider that this is the correction of an error.

Attachment B Outstanding amendments proposed earlier to Fonterra

- B1 This Attachment provides a summary of the amendments that we have proposed to Fonterra through both the Manual and calculation reviews, which have not been adopted. For the continuity of our reviews and consideration of future submission points, we consider this to be a valuable summary for all interested parties.
- B2 We consider that these outstanding amendments would:
- B2.1 better promote the purpose of the Act, as we consider the exclusion of farmer support costs is inconsistent with the contestability dimension, notwithstanding that the impact of the exclusion has not been significant to the milk price; and
 - B2.2 provide greater confidence to interested parties through additional transparency.
- B3 Table B1 outlines these outstanding Manual amendments, Fonterra's reasons and our brief comments.

Table B1 Summary of amendments proposed earlier to Fonterra

Manual reference	Detail	Category	First raised by the Commission	Previous Commission conclusion ³²	Description of issue	Fonterra reasoning
N/A	Fonterra decision for no change	Farmer support	2015/16 calculation review	We conclude that Fonterra should include the costs of providing shareholder support to ensure continued supply to be consistent with the contestability dimension.	Financing and associated administration costs of providing farmer support loans and costs of providing other mechanisms of farmer support.	Fonterra has not changed its previous position that it is not appropriate to fund these costs from the Milk Price.
Part A, Section 2.6	Fonterra decision for no change	Consistency over time - disclosure requirement	2016/17 Manual review	No consistency issue; however, we consider such disclosure would provide greater transparency.	We consider the Manual should outline what is considered a 'material change' when considering a change to the Manual and specify the timeliness of making such a change in order to set a minimum level for disclosure of changes.	Fonterra has not changed its previous position for reasons explained on page 5 of their submission on our F17 Draft Manual Report (a 'bright line' materiality threshold is likely to lead to less disclosure).

³² Our previous conclusions in these areas from prior reviews. These reports can be found at <http://www.comcom.govt.nz/regulated-industries/dairy-industry/review-of-fonterra-s-farm-gate-milk-price-and-manual/>.

Manual reference	Detail	Category	First raised by the Commission	Previous Commission conclusion ³²	Description of issue	Fonterra reasoning
Part B, Rule 26	Fonterra decision for no change	Capacity of standard plants	2016/17 Manual review	We recommend Fonterra considers disclosing its plant capacity for both primary and secondary plants in the Manual early in each season to provide certainty of the notional processors' assumed capacity for the related season. We consider this would improve the ability of interested parties to assess the practical feasibility of the assumed production volumes.	We recommend that Fonterra considers disclosing its plant capacity for both primary and secondary plants in the Manual. This earlier disclosure should provide increased transparency of the assumed capacity of the notional processor for the season. We consider Fonterra's latest amendment still allows a significant level of discretion.	Fonterra has not changed its previous position that it does not consider the Manual is the appropriate vehicle for these disclosures. Fonterra outlines that it has previously put this information into the public domain, including in the F19 Base Milk Price Reasons Paper, and the relevant assumptions will not be revisited until F20, with any changes not taking effect until F21.
N/A	Fonterra decision for no change	Actual FX rates assumed	2016/17 Manual review	We suggest there should be more transparency of information on the actual FXD rates assumed to be achieved by the notional processor.	We consider there should be more transparency of information on the actual foreign exchange rates assumed to be achieved by the notional processor. We suggest providing an average FX conversion rate assumed to be achieved by the notional processor throughout the season.	Fonterra considers that this matter is outside scope of Manual. ³³

³³ Although outside of the scope of the Manual and a safe harbour under the Act, we consider the disclosure of the assumed rates would promote the purpose of the Act. We note this does not affect our ability to conclude on the Manual.

Attachment C Glossary

Term/Abbreviation	Definition
AMF	Anhydrous milk fat
The Act	Dairy Industry Restructuring Act 2001
Base milk price	Farm gate milk price expressed per kilogram of milk solids
Calculation review	Review of Fonterra's base milk price calculation for the prior season
Dairy season	1 June to 31 May annually
FX	Foreign exchange
GDT	GlobalDairyTrade, Fonterra's online auction platform used to sell commodity products
kgMS	Kilogram of milk solids
Manual review	Review of Fonterra's Milk Price Manual for the current season
MPG	Milk Price Group
Milk Price Manual or the Manual	Fonterra's Milk Price Manual
MPP	Milk Price Panel
Notional processor	The notional commodity business that is used to calculate the base milk price (in its Reasons paper Fonterra uses the term notional producer).
QRS	Qualifying Reference Sale
QOS	Qualifying Outlier Sale
RCP	Reference Commodity Product
R&M	Repairs and maintenance
Reasons paper	Fonterra's Reasons paper which is provided alongside the Manual for each dairy season (this is also provided when Fonterra discloses its base milk price calculation at the end of each dairy season)
SMP	Skim milk powder
WMP	Whole milk powder